CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE

Minutes
February 19, 2008

The Capital Projects and Bond Oversight Committee met on Tuesday, February 19, 2008, at 12:00 PM, in Room 169 of the Capitol Annex. Representative Mike Denham, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Representative Mike Denham, Co-Chair; Senator Elizabeth Tori, Co-Chair; Senators Tom Buford and Jerry Rhoads; and Representatives Robert Damron, Steven Rudy, and Jim Wayne.

Guests testifying before the Committee: Garlan Vanhook and Doug Teague, Administrative Office of the Courts; Judge Robert McGinnis, Robertson County; Bob Wiseman, University of Kentucky; Tony Newberry, Jefferson Community and Technical College; Gary Cloyd and Rebecca Weatherford, Kentucky Community and Technical College System; Jim Abbott and Nancy Brownlee, Finance and Administration Cabinet; John Hicks, Governor's Office for Policy and Management; Tom Howard and Terri Fugate, Office of Financial Management; John Nicholson, Kentucky Horse Park Commission; Roger Peterman, Peck, Shaffer, and Williams; Brad Burgess and Joe Straka, Bluegrass Equine and Tourism Foundation; Inc.; Sandy Williams, Kentucky Infrastructure Authority; and Katie Smith, Cabinet for Economic Development.

LRC Staff: Nancy Osborne, Shawn Bowen, Kristi Culpepper, Pat Ingram, and Lesa Prewitt.

Representative Rudy made a motion to approve the minutes of the January 18, 2008, meeting. The motion was seconded by Senator Tori and approved by voice vote.

Representative Denham asked Nancy Osborne, Committee Staff Administrator, to review the correspondence and information items. Ms. Osborne said the first item of correspondence was a report from the University of Louisville regarding the purchase of unbudgeted scientific research equipment. She then briefly reviewed various items related to court facilities and state construction bids as well as proposed legislation of interest to the Capital Projects and Bond Oversight Committee.

Representative Denham asked Garlan Vanhook, General Manager of Facilities, Administrative Office of the Courts (AOC), and Doug Teague, AOC, to present the AOC reports. Mr. Vanhook said the projects were going well and all projects authorized by the

General Assembly in the 2005 Regular Session have architects and sites selected. Only one project authorized in 2005, Pulaski County, has not been bid or had bonds sold.

Representative Denham asked if funds in the Court Facility Use Allowance Contingency Fund were sufficient for any cost overruns for the court facility projects. Mr. Vanhook said at this point all projects are within the budgeted use allowances that were authorized.

Mr. Vanhook then discussed a request for a scope increase for the Robertson County Judicial Center. The project calls for a one-story addition to the courthouse and minor renovations to the existing facility. This project was authorized by the 2005 General Assembly as part of a project pool with a $199,000 use allowance. Mr. Vanhook said the scope was developed for the 2002-04 budget and was not adjusted for inflation. AOC is requesting the Committee's approval to increase the scope (use allowance) by 15%. The funds will be used to address overruns for the addition only.

Representative Denham said he was very aware of the Robertson County Judicial Center project because it was in an adjoining county to the district he represents. He said this project is very important to the county. Mr. Vanhook said this project will add a small modern court room and a new office for the court clerk. He added that the current clerk's office is a two room, 12' x 18' building that sits behind the historic courthouse. He said the existing courthouse was completed in 1864 or 1867.

Mr. Vanhook said originally all bids were well above the authorized budget. After value engineering was completed, AOC re-bid the project. In the second round of bidding there was only one bidder, which was also over budget. He said AOC used the county's model procurement code and negotiated with the sole bidder. With the approval of the 15% use allowance, this project can go forward.

Senator Tori asked if the courthouse had been restored. Mr. Vanhook said the historic building had not been restored, and the request today is for the annex that is being attached to the historic building. He said AOC bid this project with alternatives identified for minor renovations to the historic building in order to protect it. AOC plans to utilize its maintenance funds to address those small projects.

Senator Tori asked if there were any future plans to use the historic courthouse as a tourist attraction. Circuit Judge Robert McGinnis, Robertson County, came to the table. He said they have not considered this option. He explained that the county does not have the money to maintain the building without the help of the court system, and if the building was a tourist attraction it would have to be maintained by some agency in the county. He said the new section of the courthouse will not be big enough to serve some of the county's functions which is why they need to continue using the old courtroom that is much bigger than the one that will be in the new addition.

Representative Denham agreed with Judge McGinnis that Robertson County does not have the funding necessary to make the old courthouse a tourist attraction; however, he said there is a big tourism development movement in the county. For example, the Johnson Creek Covered Bridge is being restored. He said restoring the courthouse as a tourist attraction is a possibility in the future, but the county would need help to do so.

Mr. Vanhook said the courthouse would qualify as a tourist attraction from the standpoint that it is still in its original condition and is on the National Register of Historic Buildings.

Senator Tori asked how many people were served in the courthouse on a daily basis. Judge McGinnis said District Court meets weekly and when cases are tried, space is needed for at least 50 to 60 people. When the jury orientation is conducted annually, 125-150 people must be accommodated, which the old courtroom will hold.

Senator Tori said she was concerned about the money being spent on this project, considering the county's small population of less than 3,000.

Representative Denham said the courthouse and the school are the center of activity in Robertson County. The county is a large farming community with little industry. Judge McGinnis said the county is small but the people deserve a facility just like all the other counties. He said these people have been working in the worse possible conditions of any court in the state; the clerk's office has no bathroom, and the courtroom is in terrible shape, but can be renovated without a lot of expense.

Representative Wayne said he had concerns about the larger issue, which is the state's outdated and inefficient number of counties that result in government structures in small counties being subsidized by the rest of the state. He agreed with Judge McGinnis that Robertson County deserves a good facility, but he questioned whether a facility is needed in Robertson County or if services should be consolidated regionally.

Senator Rhoads said that each of the 120 counties deserves a dignified facility to hold court.

Senator Buford agreed with Senator Rhoads, saying the county was created and the General Assembly has the obligation to see that the court systems are maintained through AOC. He said he understood Representative Wayne's comments, but any time the state undertakes building or improving a facility or a courthouse, the entire state is responsible for picking up that tab. He added that a court facility in Garrard County in his Senate District will cost $28 million.

Senator Rhoads made a motion to approve the increase. The motion was seconded by Senator Buford and passed by roll call vote. Five members voted affirmatively and two members voted "No." The revised use allowance for the project is $228,850.

Representative Denham asked Bob Wiseman, Vice President for Facilities Management, University of Kentucky (UK), to discuss a scope increase for the Construct Student Health Facility project. This project was authorized in the 2004-06 budget at a scope of $24,000,000 (agency bonds). Mr. Wiseman said the scope increase of $1,000,000 is from interest income from the bonds. The funds are needed due to higher materials costs and the need to remove unstable subsurface rock encountered during excavation.

Mr. Wiseman said the project is located on a corner of Rose Street and Limestone and adjacent to the Wethington Building. He said this is a difficult construction site and involves having off-site staging. The University thought that by having the student health facility adjacent to the clinics and the hospital, operational efficiencies would be achieved and would offset any construction cost increases.

Representative Wayne made a motion to approve the scope increase. The motion was seconded by Representative Damron and passed by unanimous roll call vote. The revised project scope is $25,000,000.

Representative Denham asked Gary Cloyd, System Director of Facilities Management, Kentucky Community and Technical College System (KCTCS), Rebecca Weatherford, Director of Property Management, KCTCS, and Tony Newberry, President, Jefferson Community and Technical College (JCTC), to discuss a lease report. Mr. Cloyd reported a new lease for JCTC (PR-0079) in Shepherdsville for approximately 12,700 square feet of classroom and office space. He said the space is being rented from the Bullitt County Board of Education for use as an interim Bullitt County campus of JCTC while the college pursues funding for a permanent Bullitt County campus.

Mr. Cloyd said the annual cost of the leased space is $133,329 or $10.50 square foot (SF) which is in line with the average cost for leased space in Bullitt County. Parking is included in the lease. The college will pay an additional $5.16 SF for utilities and janitorial services for a total lease cost of approximately $198,000 per year.

Mr. Cloyd said this lease also represents JCTC's participation in a One-Stop Career Center (Center) for all of Bullitt County that provides education, training and employment services, and vocational rehabilitation services. Other participants in this Center include the Kentucky Office of Employment and Training, the Kentucky Office of Vocational Rehabilitation, KentuckianaWorks Career One-Stop, and the Bullitt County Adult and Community Education Program. Each participant in this Center has its own lease arrangement with the Bullitt County Board of Education.

Mr. Cloyd said the terms of the lease were finalized in mid-December and the lease was executed on January 10. He apologized to the Committee for allowing the lease to go forward prior to the Committee's review and approval, and explained that he misinterpreted the statutes, thinking this item was to be reported as an information item only. He said he has since learned from Committee staff that a lease is to be reviewed and approved by the Committee prior to its execution. Since the lease had been executed, the Committee took no action.

Representative Denham next asked Nancy Brownlee, Director, Division of Real Properties, to discuss a lease renewal report and five lease modifications. Ms. Brownlee discussed the lease renewal for the Office of the Governor (PR-4647) with the State Services Organization in Washington, D.C. She said this lease is for 2,030 SF of space in the Hall of States Building. This space enables the Governor's Office to maintain a staff person locally to strengthen the state's relationship with the Kentucky congressional delegation and to work with them on projects vital to Kentucky's economic and educational growth. The original lease expired January 31, 2008, and as part of the renewal process, the federal General Services Administration requested a rental rate increase from $43.85 to $59.69 SF. The terms of the lease will be extended to January 31, 2014, with a new rental rate of $121,175 per year. There are two subleases of this space for a total of 250 SF with the state of North Dakota and Connect Kentucky; both sublease rentals are reimbursable to the Governor's Office.

Ms. Brownlee said the rental rate has remained unchanged for this lease since November 2001. Because no existing statutes directly govern leasing property located outside the state of Kentucky, the Finance and Administration Cabinet's legal staff and others are working with the Committee staff to develop proposed legislation addressing the lease of property in foreign jurisdictions.

Representative Denham said that hopefully legislation would be filed as early as this week. He said two weeks ago, the need for legislation was brought to his attention. Ms. Brownlee noted these types of leases are rare.

Senator Tori asked Ms. Brownlee how many people are in the Washington, D.C. office. Ms. Brownlee said she was not sure but the Governor's Office occupies space in that office and the subleasees, North Dakota and Connect Kentucky, occupy about 250 SF of the total 2,030 SF. (Connect Kentucky plans to increase its leased space by approximately 138 SF.)

Senator Tori said she was concerned about a consulting firm, which she understood occupied a portion of the space, that was not providing much assistance on the Base Realignment and Closure Commission (BRAC) issue. Ms. Brownlee said was not familiar with the situation but would investigate it and report back.

Representative Damron made a motion to approve the lease renewal. The motion was seconded by Senator Tori and passed by unanimous roll call vote.

Ms. Brownlee then reported five lease modifications that changed the overall square footage and total annual rent, but not the rate per square foot. Three are for the Unified Prosecutorial System in Bell, Christian, and Montgomery Counties. One is for the Department of Public Advocacy in Bell County, and one is for the Cabinet for Health and Family Services, Division of Community Based Services, in Johnson County. No action is required by the Committee for lease modifications of less than $50,000.

John Hicks, Deputy Budget Director, Governor's Office for Policy and Management (GOPM), presented the monthly project report submitted by the Finance and Administration Cabinet. Mr. Hicks first reported an unbudgeted project for the Kentucky Higher Education Assistance Authority (KHEAA) to purchase a Mobile Outreach Center vehicle at a cost of $300,000. The project will be funded with federal funds from excess earnings KHEAA generates as a guarantee agency for the Federal Family Education Loan Program. Mr. Hicks said the new vehicle will replace an existing vehicle currently being used for statewide outreach efforts.

Representative Damron made a motion to approve the project. The motion was seconded by Senator Buford and passed by unanimous roll call vote.

Mr. Hicks next discussed the reallocation of the Department of Parks' $60 million Parks Development Pool authorized in the 2006-08 budget. He said the Governor and the Commerce Cabinet Secretary have announced the reallocation of $28.6 million to two new projects at the Kentucky Horse Park (KHP): the Outdoor Equine Event Stadium project ($24,600,000) and the Add Exhibit Space to Indoor Arena project ($4,000,000). The Outdoor Stadium project will provide about 7,400 permanent seats and is designed so that 22,600 temporary seats can be added for the 2010 World Equestrian Games. Mr. Hicks said there is a very tight timeline for this project. Construction is scheduled to begin immediately after the Rolex 3-day event in April 2008 with the goal that the facility be complete by the April 2009 Rolex event.

Mr. Hicks said the second project will enhance the Indoor Arena project approved by the 2006 General Assembly by adding exhibit space. The scope of the Indoor Arena project was not sufficient to accommodate the exhibition space needed for both the World Equestrian Games and the subsequent events. Therefore, $4 million is being reallocated to the Indoor Arena project to add about 20,000 square feet of exhibit space, as well as to complete the parking lot. He said the Indoor Arena is under construction and scheduled for completion by May 2009.

Mr. Hicks said the $28.6 million will be transferred from prior allocations to about 12 projects that were reported to the Committee in November 2007.

The Parks Development Pool was not specifically authorized for KHP projects in the budget bill. Representative Denham asked Mr. Hicks to clarify the authority to use this pool for this purpose. Mr. Hicks said KHP was an eligible facility to receive funding from the Parks Development Pool as it is a state park. No action was required by the Committee.

Mr. Hicks then discussed a scope increase for the Kentucky Horse Park - Construct Hotel/Conference Center project, a private development on state property. Tom Howard, Executive Director, Office of Financial Management (OFM), John Nicholson, Executive Director, KHP, and Roger Peterman, Bond Counsel, Peck, Shaffer & Williams, joined Mr. Hicks at the table.

Mr. Hicks said the 2006-08 budget bill authorized a capital project to construct a hotel/conference center at KHP using private funds of $27,500,000. This request is for a privately-funded increase of $62,500,000 for a revised scope of $90 million. The project's private developer was selected through a Request for Proposals (RFP) process and the state is executing a 42-year ground lease with the developer. In addition, the Commonwealth had identified an on-site hotel in its bid to host the 2010 World Equestrian Games (WEG) at KHP.

Mr. Hicks said this project is the culmination of a four-year process to develop a hotel/conference center at KHP. The procurement process for the hotel and associated facilities began in 2003 with the issuance of a Request for Information (RFI) by the Finance and Administration Cabinet (Cabinet). In July 2004, the Cabinet issued a RFP soliciting private developers to develop, construct, operate, and maintain a hotel/conference center at KHP. There was one response to the RFP. During the state's negotiations with that respondent, the 2005 General Assembly amended the law relating to tax credits for tourism-attraction projects whereby tax credits that previously were available to private development on private property were extended to projects located at state parks, KHP, and federal land leased by the state for parks purposes. Mr. Hicks said because of the material change in the tax laws favoring such developments, the Cabinet decided to reissue the original RFP to insure that all parties were aware of the tax incentives.

Mr. Hicks said project negotiations were ongoing as the 2006-08 budget process was underway, so the proposed hotel/conference center was included in KHP's agency budget request at a scope of $27.5 million. At the time, the amount represented solely the construction costs of the initial proposal to the original RFP and did not include other costs such as design, consulting, project management, equipment, and furniture. Ultimately, the RFP was cancelled in late October 2006 as the terms for financing the project could not be worked out. In November 2006, the Cabinet issued another RFP to which there were two responses. Based upon the state's selection process, the contract was awarded by the Cabinet to a non-profit entity, the Bluegrass Equine and Tourism Foundation, Inc. (BETF).

Mr. Hicks said the current proposal includes construction of a 267-room Westin Luxury Resort hotel/conference center and associated retail and spa facilities at a total scope of $90 million for all costs associated with the project. The Finance Cabinet Secretary has approved the appropriation increase as it is financed from private funds.

Mr. Nicholson added a hotel has long been in KHP's master plan and is a key component for the park to reach its potential. The hotel, along with the other projects currently underway at KHP, will make the park a year-long attraction and put it in a strong competitive position to recruit large national and international events. Organizers of these type of events have long indicated they would come to KHP if it had the same amenities provided at other locations.

Mr. Nicholson said the 2010 Alltech World Equestrian Games certainly served to accelerate the project. When Kentucky presented its bid in 2004 and 2005 to host the WEG, KHP's plan for a resort hotel were included to make a dramatic global statement. Kentucky has an opportunity not only to demonstrate that it is the horse capital of the world, but a significant player upon the world stage in terms of commerce, culture, education, and overall quality of life. Mr. Nicholson said he believed that having a fully functioning Kentucky Horse Park by 2010 with this resort hotel in place will make an impressive statement about Kentucky to the international community.

As important as this hotel is for the 2010 World Games, Mr. Nicholson said, it is more important for KHP's future as a true tourism destination. About 900,000 people utilize the park annually, which is projected to increase significantly due to the new facilities. Mr. Nicholson said KHP is one of the leading venues for equestrian competitions in the world and hosts 70 major horse shows and competitions annually. This includes the Rolex 3-Day Event that is broadcast throughout several nations. He predicted that an economic impact equal to that of the WEG will be realized each year with new events recruited to the park because of this hotel and the other facilities.

Mr. Nicholson noted that large equine events are already booked or are interested in booking future events and the planned hotel has played a major role in their interest. He said the absence or serious delay of the hotel may put these bookings in peril. The National Horse Center, the horse industry's leadership center, is located at KHP and houses 34 organizations, each of which holds numerous meetings, conferences, and conventions. He concluded by saying the hotel project is not only critical to KHP's ability to produce the greatest World Equestrian Games in history, but more importantly, it will make KHP the premier equestrian facility in the world and a source of state pride.

Representative Denham asked if hosting the WEG is conditioned upon construction of the hotel. Mr. Nicholson said it was not a condition, but has increased the level of attraction to the 2010 WEG.

Representative Wayne said he did not understand how the project would be financially feasible and questioned how the project's numbers were derived. He said for the $90 million project to cash flow, the cost per room was going to have to average $337 per night, based upon an occupancy rate of 59%.

Mr. Hicks then asked Mr. Peterman and Mr. Howard to describe the financing structure related to the Kentucky Economic Development Finance Authority (KEDFA) bond issue. KEDFA will issue $118,130,000 in tax-exempt bonds on behalf of BETF, which will use the proceeds to build and equip the 267-room hotel and associated facilities on the grounds of KHP.

Mr. Peterman said KEDFA adopted the final bond resolution at a special meeting last Friday, February 15, that authorized the bond issue to move forward. The project will be owned by BETF, which has received a 501(c)(3) designation from the Internal Revenue Service (IRS). This designation provides BETF tax-exempt financing status for this project even though it is a private entity. Bonds will be issued by KEDFA and the money will be loaned to BETF, which will then enter into a series of contracts to build and operate the project. BETF has leased rights to build on state property at KHP through a ground lease with the Finance Cabinet. The hotel will be operated under a license agreement with the Starwood Corporation under a Westin License Agreement and the hotel will be managed by Prism.

The bonds will be issued in two series: the Senior Series A bonds of approximately $76 million is being marketed with a debt service coverage ratio of 1.5, meaning the revenues of the project, after payment of all operating costs, will be 1.5 times the annual debt service in any given year.

The Subordinate Series B Bonds of approximately $42 million are subordinate to the Senior Series A Bonds in priority of the pledge of revenues to pay debt service. After the Senior Series A bonds are paid, and the covenant requirement for 1.5 times debt services coverage is established, the covenant requirement for the subordinate bonds is 1.1.

Based on the commissioned feasibility study, the cash flow projections indicated a 1.75 debt service coverage ratio with room rates approximately $175 per night. Mr. Peterman said the average combined debt service coverage of 1.25 for senior and subordinate bonds should be satisfied. The senior bonds would be fixed rate bonds with a maturity of 30 years. The subordinate bonds would have a fixed rate until August 1, 2013, and thereafter, the rate would adjust annually to a rate that would be established by the remarketing agent as the market rate for the following year for similar bonds.

In addition to a pledge of the revenues and a mortgage on the ground lease, the bonds will be secured by a debt service reserve fund that will be borrowed as part of the bond issue. The first excess revenues generated above debt service and above operating costs are required to be deposited in a second cash-funded reserve. The borrowed debt service reserve will be equal to one year's maximum principal and interest in any future year. The cash-funded reserve will be equal to the second year's maximum principal and interest in any future year. Finally, for the subordinate bonds only, an escrow reserve fund is established in the amount of $3 million borrowed from the Kentucky Tourism Development Finance Authority as further security.

To summarize, Mr. Peterman said the senior bonds are secured by a senior lien on revenues, a borrowed debt service reserve, and a cash-funded debt service reserve. The subordinate bonds are secured by a subordinate lien on revenues, a borrowed debt service reserve, a cash-funded debt service reserve, and an escrow debt service reserve.

He further discussed a feature unique to the subordinate bonds where bondholders have the right to tender them beginning in the year 2014. This feature was included because the potential purchasers for these bonds, in some instances, are commercial banks that do not want to invest their funds at a fixed rate for 30 years. To accommodate those investors, a put feature was included as part of the structure that gives them the right to put the bonds back to the issuer. At that time, the remarketing agent would have to find new investors to purchase the bonds. If the bonds cannot be remarketed to another holder, there is a provision in the ground lease that the Finance Cabinet, which is a party to the ground lease with the 501(c)(3) corporation, would have a duty to seek an appropriation from the General Assembly to help support the remarketing of those bonds.

Mr. Howard said the sub-prime mortgage crisis and the resulting spillover into the bond insurance market has severely hampered liquidity and confidence in the municipal bond market. It is very difficult for new project revenue credits to achieve financing in today's market at the traditional low rates they would have achieved had the bonds been insured or otherwise been accepted by the market. He said this particular project being so unique and under these very difficult market circumstances required a unique financing solution as outlined by Mr. Peterman. At the present time, this appears to be the only solution that would provide the financing for the subordinate series of bonds at interest rates to make this a viable transaction. He added that the rates they received as quotes back when the double-digit range for the subordinate piece had these characteristics had not been blended into the financing, that including the internally funded reserves, the escrow reserves, and the bond-funded debt service reserve in addition to the request for an appropriation.

Mr. Howard said a feature that provides additional security under the ground lease is that if BETF taps the escrowed debt service reserve fund, BETF would be in default under the ground lease. This default would allow the Finance and Administration Cabinet and the Commerce Cabinet to step in and take a pro-active management stance to correct the financial difficulties of the hotel. Along with the remarketing provisions provided in the structure, there would be an opportunity to restructure the loan prior to recommending that the General Assembly appropriate state funds. These additional features provide the state a great deal of control over the project.

Mr. Howard said the Senior Series A bonds are not a contingent liability of the Commonwealth and are secured solely by the project revenues. It is strictly the Subordinate Series B bonds that are subject to the increased reserve, the escrow reserve as well as the contingent liability associated with the request for an appropriation. Absent this feature, it is clearly stated on the face of the offering document that the Commonwealth does not intend to appropriate any funds for this project.

Representative Denham asked if Westin would operate the hotel and if it would be the only Westin hotel in the mid-west. BETF's Chairman and Developer, the Thayer Group, Brad Burgess, and Joe Straka, BEFT Vice Chairman and Developer, Boorn Partners, came to the table to respond. Mr. Burgess said that Westin is a brand, and BETF has a licensing arrangement with Westin to use the brand for the hotel. The hotel management company is Prism Hotels and Resorts of Dallas, Texas. BETF will own the facility until the 42-year lease term expires.

Representative Wayne asked if the bonds would qualify for an investment grade rating since they are not insured. Mr. Howard said the senior series may qualify for an investment grade rating, but the subordinate series would not because of the level of coverage and start-up nature of the project.

Representative Wayne asked if the members of the for-profit development LLC are represented on the non-profit's board of directors and whether they have a role in how the non-profit makes capital expenditures. Mr. Burgess responded affirmatively. He said that he and Mr. Straka were on the board of the for-profit entity, KHPWESLUX LLC, as well as the non-profit entity, BETF, when the final 501(c)(3) letter was negotiated with the IRS. He said there is now a requirement that the Governor appoint a majority of board members for this board.

Representative Wayne asked if additional board members had been appointed and if not why. Mr. Burgess said it was believed that at this point it was not necessary, and added that once the project was approved then the Governor could make those appointments. Representative Wayne stated that the corporations are making major decisions now and there exists a potential conflict of interest with these board members being one and the same from the for-profit and the non-profit. The intent of the IRS' provision was to make sure that a majority of the non-profit BETF's board was not on the board of the for-profit KHPWESLUX LLC.

Mr. Straka said the intent of the IRS was to have a majority of the board appointed by the Governor. As the 501(c)(3) corporation begins to generate cash flow from operations and after all of the reserve funds are fully funded, the hotel will continue to generate cash flow. It is at that point, through the bylaws of the 501(c)(3), that the excess cash flow will be distributed to other tourism and equine and industry related activities in the state of Kentucky. The IRS felt that representation was needed from the state to make those distributions and to make sure there was not a conflict of interest.

Mr. Straka said as a development entity, they have provided the state with a concept and a set of schematic designs and design development documents as well as a series of contracts to construct and operate the project. He said there have been no decisions on how to distribute excess cash flows, and there is no conflict of interest with the developer driving the project through its expertise.

Representative Wayne again noted that the people making up the board of directors of the LLC are also serving on the board of the 501(c)(3) corporation, which raises a question of ethics. Mr. Straka said the big decision to be made by the 501(c)(3) corporation is to move forward with the project. Representative Wayne said as he understood it the whole project was in the hands of the 501(c)(3) entity, and if this project collapses, the bondholders will come back to the state and ask for money to prop up the project.

In response to another question from Representative Wayne, Mr. Howard said the approximate development fee is $5 million with respect to Boorn Partners and the Thayer Group, incorporated as KHPWESLUX LLC. The financial underwriting to be earned by Ross, Sinclaire and Associates (RSA) is approximately $1.6 million.

Representative Wayne asked how RSA can serve as the underwriter, the remarketing agent, and the financial advisor, as this appears to be a conflict of interest. Mr. Peterman said Ross, Sinclaire's role is actually as placement agent and there is not an underwriter or a financial advisor in this transaction. He explained that they play a role that is very similar to an underwriter, but the bonds will be directly placed with the ultimate purchasers of the bonds rather than being purchased by Ross, Sinclaire and resold to those bond holders. There is a placement agent fee proposed for that. Mr. Peterman said in terms of a remarketing agent, that is a role that would begin in 2013 if bonds are actually tendered at that time, but this is typically an underwriter. Representative Wayne asked if there was a independent financial advisor and if not, would one be advisable for this project considering how fragile it is. Mr. Howard said there was not. He said this particular transaction was bid out under an RFP, and the

Finance and Administration Cabinet selected the developer along with their financial team as it was presented so it was procured through the typical process.

Mr. Peterman said a lot of transactions are done this way, with an underwriter and no financial advisor. If there is a competitive sale of bonds, when bonds are actually bid, then the role of the financial institution involved in the sale of those bonds is generally referred to as a financial advisor, there is no underwriter at the time bids are taken for the bonds in a competitive sale. Underwriters just bid on the price of the bonds, they are not involved in any structuring. In a negotiated bond sale, like this one, those functions generally are not divided up into two roles. The underwriter is not only involved in the structuring but also in the pricing of the bonds because it is not a competitive sale. This is a typical structure that would be used by the Turnpike Authority and the State Property and Buildings Commission. Mr. Peterman said there are instances where entities will have their own financial advisor that will be separate from the underwriter. There are some transactions like this but working with just an underwriter to structure and price a transaction is fairly common.

Representative Wayne said it seems as if this is a very fragile financial proposal and to have an independent financial advisor may be beneficial. He asked for an explanation of the project revenues and commented that the Lexington market may not be able to sustain a 59% occupancy rate after the 2010 WEG. Mr. Nicholson said two feasibility studies were completed. One was paid for by the developer and is being used by the investors and the potential purchasers of the Series A bonds. The other feasibility study was commissioned by the Department of Tourism to determine the project's qualification for tax incentives under the 2005 Tourism Development Act. He said both studies concluded almost exactly the same results, that is the average daily rate would be approximately $174 per night, which is in line with what Westin says is typical for hotels with their brand. The studies also projected that the occupancy level will be close to 74% or 75% throughout a 20-year period.

Representative Wayne said based on information from his advisors, these figures are highly unlikely given the market of Lexington and the cost per room. He believed the studies' model understates the room rates and overstates the occupancy rates. Mr. Straka said a rule of thumb used by the industry is that the room rate is tied as a percentage to the total gross cost of the entire project. He said this is how the $337 per room was derived.

Mr. Straka commented that Representative Wayne's approach is used under traditional commercial lending. However, when he was involved with the first proposal in 2004 with a previous company, it was found that this hotel with this kind of quality and design cannot be financed conventionally.

Mr. Straka said when they returned with a proposal a year and a half ago, they came up with a structure for the tax-exempt bond market. The Smith Travel Report will give a conglomeration of all the hotels in which the lower-end hotels will drag down the rate of the higher end hotels. When looking at the competitive set of hotels in Lexington, they perform at a higher rate than reported. This feasibility study has been supported by the Charles H. Johnson Company, Chicago, one of the foremost feasibility consultants in the country. Economic Research Associates, Chicago, which was commissioned by the Tourism Development Cabinet, supported the same findings in order to support BETF's application for the tax rebate incentive program.

Representative Wayne thanked those involved for the work they were doing.

Senator Buford commented that this is a difficult situation and that much of the financing is being proposed in this manner because the project needs to be rushed. He said he appreciated those at the table putting their reputations on the line in indicating that this project was going to work. He said this project is not what this Committee is accustomed to considering because usually state-owned properties and state programs are financed through bond funding.

Senator Buford said if the state tried to bond this project itself and administer it, the state would lose money. He added that the 501(c)(3) corporation would ultimately maintain its tax-exempt status. With the Westin brand, it is going to be a profitable asset for KHP. He said there is also the issue of the revenues that will be generated by the World Equestrian Games, which is projected to be at a minimum $164 million. He said it seems that a small amount of money is being paid to Ross, Sinclaire to provide their services in two areas, and it appears that everyone is making a sacrifice to ensure that this project is successful. He asked that members realize that they will probably never see a project like this again. Senator Buford said he thought highly of Governor Brashear who had taken his time to put this together.

Representative Wayne said he thought the project had serious problems, as recognized by all the convoluted structuring of the two corporations and the convoluted financial package. He said he was concerned about the conflict of interest, the feasibility of the project, the precedent being set, and that the state will end up paying for the project with state appropriations.

Representative Wayne then asked if a precedent was being set that future conduit bonds issues may include a pledge to seek state appropriations. Mr. Howard said he was not aware of an appropriation being associated with a conduit deal, but there is a distinction between this and other projects. This project is on state land and the state will own the project at the end of the term of the lease. The project's financing also utilizes tourism development tax credits generated from sales taxes and pledged by the developer back to the project. He concluded the Commonwealth has a very strong interest in this property unlike many other conduits that would finance more traditional revenue generating projects.

Representative Denham noted that this project is listed as privately funded in the budget bill, and asked under the current financial structure if the funding still qualified as private funds within the meaning of the budget item. Mr. Hicks said yes because the bonds that are being issued to finance the project are tax-exempt industrial revenue bonds issued by and on behalf of BETF, a private entity. They are not governmental funds.

Representative Denham asked if the state will own the hotel and associated facilities after the ground lease expires. Mr. Howard responded affirmatively.

Representative Denham asked what would happen if the bonds could not be sold. Mr. Peterman said if the bonds are not sold, the project would not be financed. Assuming there is an affirmative vote today, final negotiations will be entered into with potential purchasers. He said there has been a lot of discussion with potential buyers of the bonds at this point, but nothing is assured.

Representative Denham asked what interest rates are projected for the bonds. Mr. Peterman said the core projections included in the offering document being sent to potential investors are 6.75% on the senior bonds and 4.5% on the subordinate bonds.

Representative Denham asked if the Commonwealth would be liable for any cost associated with this if the bonds are not sold. Mr. Peterman said there would be no cost to the Commonwealth. He noted that everyone who is working on this project is totally at risk with their time and efforts expended to date. Representative Denham asked Mr. Howard if he agreed with this assessment. Mr. Howard responded affirmatively.

Representative Denham asked what the total project fees are, other than capitalized interest. Mr. Peterman said transaction fees are approximately 1.6% of the issue size which includes financial and legal fees. He said the IRS guidelines provide that a maximum of 2% may be used to pay transaction costs for tax-exempt bond issues.

Representative Denham asked officials to bring the Committee up-to-date from 2006 when negotiations started between developers, KHP, GOPM, and the Finance Cabinet. Mr. Straka said that after the RFP was reissued in November 2006 and proposals were evaluated, a number of things happened. Proposals were due in December, and at the end of January verbal presentations were made to the Finance Cabinet's Selection Committee. The contract was awarded in May 2007 and the ground lease was negotiated and agreed upon in July 2007. In August 2007, there were numerous conversations with Mr. Howard and the Finance Cabinet about financing options. It was not until November 2007 that under the leadership of Finance Cabinet Deputy Secretary Lori Flannery, Mr. Howard, and others in the Commerce Cabinet that substantial progress was made.

Representative Wayne asked if the Subordinate Series B bonds cannot be successfully remarketed and the General Assembly is asked to appropriate funds, would failure to appropriate state funds affect the way the state's debt is perceived by market participants and by the rating agencies. Mr. Howard said if the General Assembly did not appropriate funds under those circumstances, it would be the first time in history that the Commonwealth would not have appropriated debt service for an obligation. A failure to appropriate funds would not be perceived as a positive credit event by the market. Once an appropriation is made, it would be included in the debt capacity models.

Representative Wayne asked if this would hurt the state's bond rating. Mr. Howard said it would not help the state's market position. Even though the bonds represent a relatively small amount of money, the action would be precedent setting and would be problematic.

Representative Denham said he appreciated the gentlemen coming to the meeting to answer questions. He said they have worked hard, and this project has spanned two administrations. He said this is a major project that is important to the Commonwealth, but it has its share of problems.

Senator Buford made a motion to approve the KHP project scope increase. The motion was seconded by Senator Rhoads and passed by roll call vote. One member voted to "Pass" and one member voted "No." The revised project scope is $90 million.

Representative Damron explained his "Pass" vote. He said although he has had nothing to do with this bond issue, the firm that he works with is involved with this project.

Representative Wayne explained his "No" vote. He said his concerns have already been stated and he thinks that the project revenues are questionable. He said it would not be wise to endorse something so financially fragile that could collapse and leave the state with a white elephant.

Representative Denham explained his "Yes" vote. He said he had major concerns about how this project had come together and how the financing is structured, but the project is important to the Commonwealth.

Senator Buford made a motion to approve the KEDFA bond issue. The motion was seconded by Senator Rhoads and passed by roll call vote. One member voted to "Pass" and one member voted "No."

Representative Damron said his "Pass" vote was for the same reasons as for the previous motion. Representative Wayne said his "No" vote was also for the same reasons as for the previous motion.

The next reports were given by Mr. Howard and Terri Fugate, Deputy Executive Director, OFM. Mr. Howard discussed a new bond issue, State Property and Buildings Commission Revenue and Revenue Refunding Bonds Project 89, $426,378,855. Proceeds from this issue will advance refund floating rate notes and provide new money for projects included in the 2004-06 and 2006-08 budgets. He said due to the turmoil in the marketplace, it appears that these notes could be purchased at a substantial discount. He said once all the expenses are netted out including a swap termination payment, an $8-10 million of present value savings is anticipated from this transaction.

Representative Damron made a motion to approve the bond issue. The motion was seconded by Senator Buford and approved by unanimous roll call vote.

Ms. Fugate presented 46 new school bond issues with School Facilities Construction Commission (SFCC) debt service participation: Barbourville Independent (Knox County), Barren County, Berea Independent (Madison County), Boone County, Bowling Green Independent (Warren County), Boyd County (2), Boyle County, Breckinridge County, Carroll County, Christian County, Danville Independent (Boyle County), Edmonson County, Erlanger-Elsmere Independent (Kenton County), Fairview Independent (Boyd County), Gallatin County, Green County, Greenup County, Harlan Independent (Harlan County), Hart County, Hickman County, Hopkins County, Jefferson County, Jessamine County, Johnson County, Lincoln County, Livingston County, Logan County, Madison County, Marshall County, Mason County, McLean County, Menifee County, Mercer County, Montgomery County, Ohio County, Paintsville Independent (Johnson County), Pike County (2), Pikeville Independent (Pike County), Rowan County, Scott County, Shelby County, and Washington County (2).

Three of these bond issues will finance new facilities (Bowling Green Independent, Breckinridge County, and Ohio County). The other 43 bond issues will refund outstanding bonds.

Senator Tori made a motion to approve the school bond issues. The motion was seconded by Senator Buford and approved by roll call vote. Representative Damron abstained from the vote, citing a potential conflict of interest.

Representative Denham next welcomed Sandy Williams, Financial Analyst, Kentucky Infrastructure Authority (KIA). Ms. Williams presented seven new KIA grants for the Committee's approval. The first request was a 2020/Fund B grant in the amount of $500,000 for the Graves County Fiscal Court. The funds will be used to retire debt as part of a transaction to merge four water districts into one entity.

Representative Rudy made a motion to approve the project. The motion was seconded by Senator Buford and approved by unanimous roll call vote.

The second request Ms. Williams reported was a Fund B (Infrastructure Revolving Fund with state-supported debt service) grant in the amount of $373,900 for the Morehead Utility Plant Board in Rowan County. The proceeds will be used to extend water lines to an industrial park and airport.

Representative Denham asked why the engineering fees for this project were high. Ms. Williams said this was part of a larger water and sewer project, and the engineering fees included in this request will be used to design a second part of the project.

Representative Damron made a motion to approve the project. The motion was seconded by Representative Rudy and approved by unanimous roll call vote.

Next Ms. Williams reported five Fund F (Federally Assisted Drinking Water Revolving Loan Fund) loans. The first loan was for the Western Fleming Water District in the amount of $2,518,000 to construct a new raw water intake and make water treatment plant improvements. These funds will be combined with a grant from 2006 HB 380 for a total project scope of $2,568,000. The loan will have a 30-year term and a 1% interest rate.

The second Fund F loan was for the Meade County Water District in the amount of $1,950,949 to extend water lines and make water system improvements. These funds will be combined with two grants from 2006 HB 380 for a total project scope of $2,480,949. The loan will have a 20-year term and a 3% interest rate.

The third Fund F loan was for the City of Berea in Madison County in the amount of $4,000,000 to upgrade raw water intake facilities and make water system improvements. These funds will be combined with a grant from 2006 HB 380 and local funds for a total project scope of $6,157,000. The loan will have a 20-year term and a 1% interest rate.

The fourth loan Ms. Williams presented was for the Frankfort Electric and Water Plant Board in Frankfort in the amount of $6,891,000 to construct a new chemical feed facility. The loan is the sole funding for this project. The Fund F loan will have at 1% interest rate for a 20-year term.

The last Fund F loan was for the City of Manchester in Clay County for $1,500,000 to construct a new 3.2 million gallon per-day water treatment plant. These funds will be combined with other project financing, including a Fund F planning loan, for a total project scope of $6,159,500. The loan will have a 30-year term and a 1% interest rate.

Representative Damron made a motion to approve the five Fund F loans. The motion was seconded by Senator Tori and approved by unanimous roll call vote.

Ms. Williams next reported various coal/tobacco development grants that were funded through line item appropriations by the General Assembly in 2005 and 2006. These items did not require Committee action.

Representative Denham next asked Katie Smith, Deputy Commissioner for the Department of Financial Incentives, Cabinet for Economic Development, to report amendments for two Economic Development Bond (EDB) grants. The first amendment reported was an extension of the jobs requirement for an EDB grant for the Augusta-Brooksville-Bracken County Industrial Authority. This $100,000 grant was approved by the Committee in June 1993 to extend water lines to an industrial park project in Bracken County. This is the third amendment to the grant.

The next amendment reported was for an EDB grant to the Southeast Kentucky Economic Development Corporation (SKED) in Pulaski County. The $400,000 grant was approved by the Committee in November 2001 to build an information technology center in Somerset. KEDFA has amended the jobs requirement for this grant to include not only jobs created in the technology center building, but jobs created by the entire complex where the technology center is located.

Representative Denham said the Bracken County Fiscal Court and the Augusta-Brooksville-Bracken County Industrial Authority were the subject of a news article. He said these entities have worked hard to bring jobs to the county. The industrial park was originally a farm and now has the potential to be one of the premier locations along the AA Highway. He said the state would not lose money because there is a letter of credit from the local banks that secures the EDB grant. He said he appreciated the Economic Development Cabinet for its hard work in regard to these projects. Representative Denham said no action was required for these grants.

Next Ms. Osborne reported 13 locally-funded school bond issues submitted to the Committee for review this month: Anchorage Independent (Jefferson County), Barren County, Bullitt County (2), Clark County, Daviess County (2), Frankfort Independent (Franklin County), Hardin County (2), Harlan County, Laurel County, and Pulaski County. Four of these bond issues will finance new facilities (Bullitt County, Daviess County, and two in Hardin County). Nine issues will refund outstanding bonds. She said all disclosure information has been filed, and no further action on the bond issues was required.

Representative Denham said the Committee's next meeting is tentatively scheduled for March 18, 2008, in the Capitol Annex Building. With there being no further business, a motion was made and seconded to adjourn the meeting. The meeting adjourned at 2:00 p.m.